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In the Supreme Court of the United States

OCTOBER TERM, 1964

No. —

UNITED STATES OF AMERICA, APPELLANT

v.

SEALY, INC.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS

JURISDICTIONAL STATEMENT

OPINION BELOW

The district court's findings of fact and conclusions of law (App. A, *infra,* pp. 1a–111a) and the final judgment (App. B, *infra,* pp. 112a–116a) are unreported.

JURISDICTION

The judgment of the district court was entered on December 30, 1964. The notice of appeal was filed on February 25, 1965. The jurisdiction of this Court is conferred by Section 2 of the Act of February 11, 1903, 32 Stat. 823, as amended, 15 U.S.C. 29. *White Motor Co.* v. *United States,* 372 U.S. 253; *United States v. Masonite Corp.,* 316 U.S. 265.

QUESTION PRESENTED

Sealy, Inc., is owned and controlled by approximately 30 bedding manufacturers. Each of them is licensed by Sealy to manufacture and sell bedding under Sealy's trademarks in mutually exclusive territories. The question presented is whether this allocation of territories among the manufacturers violates Section 1 of the Sherman Act.

STATUTE INVOLVED

Section 1 of the Sherman Act, 26 Stat. 209, as amended, 15 U.S.C. 1, provides, in pertinent part:

> SEC. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.

STATEMENT

This is a direct appeal arising out of a civil action brought by the United States, charging that Sealy, Inc., ("Sealy") had violated Section 1 of the Sherman Act by conspiring with manufacturers who make and sell bedding products under Sealy's trademarks and trade names to fix the retail sales price of such bedding products and to allocate mutually exclusive sales territories.[1] After trial, the district court held that

[1] Three other cases were brought at the same time which challenged price fixing and territorial allocation arrangements of other mattress companies—arrangements which were virtually identical to the ones challenged in this case. In two of these cases consent decrees were entered in which the companies agreed to eliminate territorial restrictions. *United States* v.

Sealy had violated Section 1 by agreeing to set minimum retail prices and by inducing retailers to adhere to such retail prices, but held that the exclusive territorial arrangements did not violate the antitrust laws (App. A, *infra*, p. 111a).

The district court's findings of fact and the undisputed documentary evidence establish the following facts: Sealy does not, itself, manufacture bedding products, but owns trade names and trademarks for such products. It licenses approximately 30 companies to manufacture and sell products under its trademarks in mutually exclusive territories (Fdgs. 12, 27, App. A, *infra*, pp. 5a, 12a). The 30 licensees are required by their license agreements to own stock in Sealy and they must offer this stock for sale to Sealy upon termination of their licenses (GX 1011–1018, 1031, 1085).[2] Collectively, the 30 manufacturers own 92 percent of the Sealy shares; the remaining 8 percent are held by officers of Sealy (Tr. 2213, 2217). Sealy's bylaws limit membership on its board of directors to representatives of its licensees (GX 31–F).

The "Sealy" trademark has been used on bedding since 1889 (Fdg. 16, App. A, *infra*, p. 6a). In 1923, the Sealy Mattress Co. was a department of Sugar Land Industries, a trust estate. By that time, Sugar Land had licensed 20 independent manufacturers to manu-

Restonic Corp., 1960 Trade Cases ¶69,739 (N.D. Ill.); *United States* v. *Spring-Air Co.*, 1962 Trade Cases ¶70,402 (N.D. Ill.). The other case is awaiting trial, *United States* v. *Serta Associates, Inc.* (N.D. Ill.).

[2] "GX —" refers to Government exhibits introduced at trial. "Tr. —" refers to the transcript of the trial.

facture and sell bedding products in restricted territories under the "Sealy" trademarks and tradenames (Fdgs. 17, 18, 27, App. A, *infra,* pp. [illegible], 7a, 12a). In 1923 Sugar Land decided to withdraw from the bedding business. It gave an option to E. E. Edwards to purchase all of the Sugar Land bedding department's intangible assets, including the "Sealy" trademarks and trade names and its license contracts (Fdg. 18, App. A, *infra,* p. 7a). In 1925, Edwards and the independent manufacturers who had been Sealy licensees formed and purchased the stock of the Sealy Corporation, which exercised the option and undertook to pay Sugar Land $150,000 for the designated assets within six years (Fdgs. 20–22, App. A, *infra,* pp. 8a–9a). As part of the organizational arrangement, the manufacturers who thus became shareholders of Sealy Corporation agreed upon a system of territorial restrictions whereby each licensee would manufacture and sell Sealy products within a designated territory and would not manufacture or sell Sealy products in any other licensee's territory (Fdg. 27, App. A, *infra,* p. 12a).

The Sealy Corporation remained in business until 1933, when it defaulted on its $150,000 debt to Sugar Land. Business failures caused by the depression had reduced the number of Sealy licensees to eight, and these eight manufacturers reorganized the company into the present Sealy, Inc. A proposal permanently to divide the entire United States among the eight remaining licensees was "seriously considered and discussed at length" at the time but was rejected

(GX 8, p. 2; Fdg. 86, App. A, *infra*, p. 36a). However, the manufacturers did agree to confine their sales of Sealy products within mutually exclusive territories and to refrain from manufacturing or selling such products in any other licensee's exclusive territory (Fdg. 27, App. A, *infra*, p. 12a). They later arranged that individual manufacturers might allocate part of their territories to other manufacturers of their selection if the new licensees would purchase stock in Sealy (GX 31-E, p. 3).

The plan to allocate exclusive territories among the manufacturers operated as follows: The manufacturers agreed to pay $10 to Sealy for each item which was sold under the Sealy trademark in another licensee's territory. This was a heavy fine for, in the early years, mattresses were priced as low as $19.75 at retail (Fdg. 128, App. A, *infra*, p. 53a). Sealy was to turn the $10 fine over to the manufacturer in whose territory the items had been sold (GX 1012–1106). When disputes arose between licensees because of claimed sales in each other's territories, Sealy encouraged the manufacturers to work out the problems among themselves (Fdg. 30, App. A, *infra*, pp. 13a, 14a). This often resulted in the licensees settling the dispute by exchanging parts of their territories (Tr. 231, 576–579, 800–804, 828–830, 940–944). In the event that the licensees could not settle such disputes between themselves, Sealy intervened and issued instructions to stop further sales in one another's territories (Tr. 1218–1222, 1240–1281, 1303–1307, 1334–1343).

At the close of the government's case in chief, the district court overruled a motion to dismiss under Rule 41(b) of the Federal Rules of Civil Procedure but stated, "should there ever be a decree there will be nothing in it finding that the territorialization, in my opinion, was a violation of the antitrust laws" (Fdg. 8, App. A, *infra*, p. 4a). Sealy thereafter limited its presentation of evidence to the issue of price fixing and, at the close of trial, renewed its motion to dismiss. The court found that, in the formation of Sealy, there had been no central conspiratorial purpose to divide the United States among competing mattress manufacturers (Fdg. 25, App. A, *infra*, pp. 10a–11a) and that the imposition of territorial restrictions was "ancillary" to the proper exploitation of the Sealy name and trademarks (Fdg. 84, App. A, *infra*, pp. 33a–34a). The court therefore concluded that there was no conspiracy to allocate markets (Fdg. 84, 119, App. A, *infra*, pp. 33a–34a, 51a–52a) and granted the motion to dismiss this part of the complaint. It went on to find that Sealy had engaged in resale price fixing in violation of Section 1 of the Sherman Act and issued an appropriate injunction (App. B, *infra*, pp. 112a–116a).

THE QUESTION IS SUBSTANTIAL

The Sherman Act prohibits competitive manufacturers from agreeing to divide territories. This rule was reaffirmed in *White Motor Co.* v. *United States*, 372 U.S. 253, 259, where the Court, although it refrained from deciding whether a *vertical* arrangement by which a manufacturer restricted the territory of

his dealers was *per se* illegal, stated, without qualification, that "[i]f competitors agree to divide markets, they run afoul of the antitrust laws." In the present case, competitive manufacturers have agreed to limit their manufacture and sale of trademarked goods to specified territories through arrangements with a trademark owner which they own and control. The district court has held these arrangements to be lawful. In our view, the arrangements in this case, although formally vertical, amount to agreements between competitors to divide markets. The decision of the district court therefore creates an important exception to the absolute prohibition upon horizontal territorial agreements and should be reversed.

1. Agreements among competitors dividing up the territories in which they would otherwise compete are *per se* illegal. *United States* v. *Addyston Pipe & Steel Co.,* 85 Fed. 271 (C.A. 6), affirmed, 175 U.S. 211; *United States* v. *National Lead Co.,* 63 F. Supp. 513 (S.D.N.Y.), affirmed, 332 U.S. 319; *Timken Roller Bearing Co.* v. *United States,* 341 U.S. 593; *United States* v. *Nationwide Trailer Rental System,* 156 F. Supp. 800 (D. Kan.), affirmed, 355 U.S. 10. Such restrictive agreements are among those which "because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." *Northern Pacific Railway Co.* v. *United States,* 356 U.S. 1, 5. *White Motor Co.* v. *United States,* 372 U.S. 253,

263, reaffirmed that "[h]orizontal territorial limitations * * * are naked restraints of trade."

The system challenged in the present case is, in effect, a "horizontal" division of territories illegal *per se* under this principle. The Sealy Corporation, which issues the licenses binding the manufacturers to limited territories, is controlled and almost entirely owned by the manufacturers whom the licenses bind not to compete with each other. Each licensee is a stockholder of Sealy; together, the licensees own 92 percent of Sealy's stock; and the Sealy board of directors is composed exclusively of representatives of the manufacturers. Thus, the decision to maintain the division of territories is in the hands of those whose competition is restrained. In concurring in *White Motor*, 372 U.S. at 267, Mr. Justice Brennan stated:

> * * * If it were clear that the territorial restrictions involved in this case had been induced solely or even primarily by appellant's dealers and distributors, it would make no difference to their legality that the restrictions were formally imposed by the manufacturer rather than through inter-dealer agreement. Cf. *Interstate Circuit, Inc.* v. *United States*, 306 U.S. 208; *United States* v. *Masonite Corp.*, 316 U.S. 265, 275–276.

We believe this view to be implicit in the opinions of all the Justices in *White Motor;* it is dispositive of the present case.

The fact that all the licensees do not have the same voice in running Sealy and that the latter has played an active role in fixing the licensees' territories and resolving disputes among them on that subject, cannot save the Sealy territorial allocation plan from condemnation as a *per se* illegal division of markets. For the critical fact is that firms operating at the same functional level—all the licensees both manufacture and sell Sealy products, and Sealy itself does neither—have agreed, through the medium of Sealy, to limit the territories in which they do business. This appeal thus squarely presents the important question, which this Court has not decided, whether competing firms which could not directly divide markets may accomplish the same thing through the issuance, by a licensor which they and own and control, of trademark licenses which limit the territories in which they may sell the trademarked products.

2. In reaching the conclusion that the territorial agreements in this case were lawful, the district court adopted the defendant's proffered findings which suggest that the primary purpose of the arrangement was to finance national advertising of Sealy products in competition with larger manufacturers of other brands, and to protect the goodwill attached to the Sealy trademarks. If we are correct that the case shows what is, in effect, a horizontal agreement between potential competitors to divide territories, then the suggested defenses are irrelevant. Since such an

agreement is illegal *per se*, any proffered legitimate purposes, such as collective advertising, are immaterial, for the essence of the *per se* rule is that no showing of reasonableness in the circumstances can prevail in the face of the evident restraint upon competition. See *Klor's, Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207; *Northern Pacific Railway Co.* v. *United States*, 356 U.S. 1; *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150. Nor does the fact that the manufacturers here utilized a single trademark exempt them from the Sherman Act. The Lanham Act provides that a trademark may not be "used to violate the antitrust laws of the United States" (Sec. 33(b)(7), 15 U.S.C. 1115(b)(7)) and this Court has held specifically that trademarks may not be used as a justification for the division of territories among competitors, *Timken Roller Bearing Co.* v. *United States*, 341 U.S. 593, 598-599. A division of territories here is not necessary to safeguard the Sealy trademark, which may be fully protected without such an arrangement by the requirement that all licensees meet quality standards imposed by Sealy.[3]

[3] We submit that the Fifth Circuit's decision in *Denison Mattress Factory* v. *Spring-Air Co.*, 308 F. 2d 403, that territorial restrictions are necessary in a case such as this to prevent confusion as to the source of the trademarked goods, is wrong. Since all the goods covered by the trademark must be of the same nature and quality (15 U.S.C. 1055, 1127), and since the purpose of using the trademark is to convince the public that all Sealy mattresses are the same, territorial restrictions cannot be justified as necessary to prevent the public from deception. In *United States* v. *Spring-Air Co.*, 1962 Trade Cases ¶70,402 (N.D. Ill.), Spring Air Co., which one month later prevailed in the *Denison* case, consented to a decree enjoining its use of territorial restrictions.

CONCLUSION

The decision of the district court permits an arrangement whereby competitive manufacturers may divide territories (and thus avoid a *per se* restriction of the antitrust laws) by taking restrictive licenses from a trademark holder whom they collectively control. This appeal presents a substantial question of importance in the administration of the Sherman Act and probable jurisdiction should be noted.

Respectfully submitted.

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